the United Security insurance then in force except its "group S"[5] business. The consideration to be paid United Security was $72,375. The board of directors of United Security, with Hyatt abstaining, authorized it to enter into an agreement with Hyatt whereby any amount due and payable to the company from Western American would be assigned to him in consideration for his transfer to United Security of his rights in the general agency contract and the insurance business covered thereby except the Group S business. Hyatt and United Security thereupon executed an agreement on November 8, 1952, which provided, in accordance with the authorization of its board of directors, that Hyatt would be entitled to receive the $72,375 payment due the company from Western American in consideration for his transfer to United Security of the general agency contract. The contract provides, in pertinent part. as follows:

Whereas, Hyatt, by virtue of a contract or agreement with United dated the 8th day of March, 1949, is the General Agent of United and as such is entitled to a substantial income,

Now, Therefore, in consideration of United assigning to Hyatt simultaneously with the sale provided for in this agreement, all of its rights and interest to receive payment from Western as follows:

(a) Seventy-two Thousand Three Hundred Seventy-five Dollars ($72,375.00) within five (5) days after the approval of a contract of reinsurance as provided in Paragraph 1 of an agreement dated the 24th day of November, 1952, between

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[5] "Group S" was a group of policyholders formed shortly after September 25, 1952, pursuant to the authorization of the United Security board of directors for the purpose of retaining in the company the minimum number of policyholders required under Texas law to qualify for an operating charter. As of November 24, 1952, Group S had more than 1,000 members with assets in excess of $2,000.

Western American Life Insurance Company and United Security Assurance Company;

Hyatt hereby sells, transfers, conveys and assigns to United all of his rights, including the income to which he is entitled in and to the General Agency Contract.

The reinsurance agreement between the two companies was ratified by the policyholders of United Security on November 24, 1952. The Board of Insurance Commissioners of Texas approved the reinsurance agreement on November 26, 1952. On December 3, 1952, Western American issued reinsurance certificates to the policyholders of United Security.

The $20,000 amount received by Hyatt in 1952 upon the transfer to United Security of his general agency contract and the $52,375 amount subsequently received by him in 1954 were reported by him as long-term capital gain on his income tax returns for 1952 and 1954, respectively.

REASONS FOR GRANTING THE WRIT

1. The decision of the Fifth Circuit in the instant case (Appendix A, *infra*, pp. 13-14) which is controlled by its earlier decision in *United States* v. *Eidson* (5th Cir. 1962), 310 F 2d 111 (Appendix B, *infra* pp. 17-29), is in conflict with the decision of the Second Circuit in *Commissioner* v. *Ferrer*, (2nd Cir. 1962), 304 F 2d 125 (Appendix C, *infra* pp. 30-52), and with another panel of the Fifth Circuit in *United States* v. *Dresser Industries, Inc.* (5th Cir. 1963), 324 F 2d 56 (Appendix D, *infra* pp. 53-65). It is also in conflict with the decision of the Ninth Circuit in *I. J. McCullough* v. *Commissioner* (9th Cir. 1964), 326 F 2d 199, insofar as the controlling legal principle is concerned. These

conflicting decisions involve the important question of whether the sale of a contractual right to conduct a commercial enterprise, requiring the risk of substantial sums of capital, is taxable as capital gain.

In the instant case the taxpayer entered into an agency contract with a life insurance company that had no assets and no policyholders. Under the contract the taxpayer was responsible for all the necessary finances and services to operate and build up the business. His remuneration, as fixed under state law, came solely from whatever remained in the expense fund after all expenses of operation had been paid. The expense fund was entitled to 40% of the premium income. After 3½ years, the contract was sold for the sum of $72,375.00. The Fifth Circuit held that the gain was taxable as ordinary income.

In *United States* v. *Dresser Industries, Inc.*, *supra*, another panel of the Fifth Circuit held that the sums received by the licensee on the sale to the patent owner of an exclusive right to practice a patent was taxable as capital gain, rather than ordinary income. This panel of the Fifth Circuit specifically criticized the reasoning of the Court in *United States* v. *Eidson*, *supra*, and cited the decision of the Second Circuit in *Commissioner* v. *Ferrer*, *supra*, in support of its holding. In that case the sale by the actor Jose Ferrer of a right to produce a stage play and the sale of the right to prevent the disposition of motion picture, radio and television rights with respect to the play were both held entitled to capital gain treatment. In *I. J. McCullough* v. *Commissioner*, *supra*, the Ninth Circuit, in reversing the Tax Court, held that the sale of an interest in patent royalties to the licensee for a fixed sum was taxable as capital gain.

2. The conflict in the tax treatment of the sale of contractual and other intangible rights[1] arises from the differences in interpretation of this Court's language in the opinion in *Commissioner* v. *P. G. Lake, Inc.*, 1958, 356 U.S. 260, as stated at page 266:

> "The substance of what was assigned was the right to receive future income. The substance of what was received was the present value of income which the recipient would otherwise obtain in the future. In short, consideration was paid for the right to receive future income, not for an increase in the value of the income producing property."

The Fifth Circuit in *United States* v. *Eidson*, *supra*, applied this statement in holding that the sums received upon the transfer of the income producing agency contract represented the present cash value of ordinary income expected over the life of the contract, and, therefore, the transfer was of a right to receive future income, as represented by the net profits of the operation, rather than a capital asset.

In the opinion of *United States* v. *Dresser Industries, Inc.*, *supra*, another panel of the Fifth Circuit, in dictum criticized the Eidson case as accepting literally the above language of this Court, " . . . to mean that any money paid which represents the present value of future income to be earned is always taxed as ordinary gains. As a legal or economic proposition, this

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[1] This issue is not resolved by section 1241 of the 1954 Internal Revenue Code which assures sale or exchange status for amounts received on the cancellation of a distributorship of goods agreement where the distributor has a substantial capital investment in the distributorship. Section 1241, however, is not exclusive. The Committee Reports to this provision specifically state that no negative inferences were to be drawn merely because the taxpayer did not qualify under the new section. S.Rep.No. 1622, 83d Cong., 2d Sess. 444(1954). Moreover, both the Second Circuit in the Ferrer case and the Fifth Circuit have abandoned the distinction between a sale to a third person and a cancellation. Bisbee-Baldwin v. Tomlinson, (5th Cir. 1963), 320 F 2d 929.

cannot be so. The only commercial value of any property is the present worth of future earnings or usefulness."

The Second Circuit in *Commissioner* v. *Ferrer*, *supra*, saw a different meaning in the *Lake* decision from that found by the Fifth Circuit in the *Eidson* case with regard to the tax treatment of the present sale of a right or property which would produce income in the future. The statement of Judge Friendly on this point is as follows:

> "We see no basis for holding that amounts paid Ferrer for surrender of his lease of the play are excluded from capital gain treatment because receipts from the play would have been ordinary income. The latter is equally true if a lessee of real property sells or surrenders a lease from which he is receiving business income or subrentals;"

For purposes of capital gains treatment, the contract to produce a play in the Ferrer case and the contract to operate a life insurance company in the instant case are indistinguishable. Each of these contracts afforded the holder an opportunity to make a profit and each imposed upon him the risk of financial losses since substantial sums of money had to be committed under each contract. Neither of these contracts were essentially for personal services although in the Ferrer case the contract did require the performance of personal services by the taxpayer himself. In the instant case the taxpayer only had to furnish the necessary services to operate the business.

The Ninth Circuit in *I. J. McCullough* v. *Commissioner*, *supra*, in holding the sale of a royalty interest

was taxable as capital gain, stressed the fact that the royalty owner prior to the sale "was a proprietor of the tree, and the amount of his income would rise or fall as the crop of fruit was large or small. After the modification, he was the proprietor of nothing except Tool Company's (the purchaser-licensee) promise to pay him a fixed sum of money in installments." This metaphor would equally apply to the factual situation in the instant case. Moreover, our taxpayer, as the owner of the tree, was required to continually fertilize it with expenditures of money in order for it to bear fruit.

In view of the government's urging that this Court's decision in the case of *Commissioner* v. *P. G. Lake*, *supra*, controls the capital gain status of the sale of contractual rights, even where substantial capital risk taking is required, and in view of the differences held by the lower Courts as to the meaning of this decision, it is important for this Court to resolve the conflict among these opinions and to determine a uniform position for the guidance of the taxpaying public.

3. The contractual right to operate a general agency for an insurance company, to produce a play, and to practice a patent are only a sampling of many common and well-recognized commercial arrangements. These include exclusive agency or management contracts; exclusive distributorship contracts; and business franchise or license agreements. The holder of such rights who by way of capital risk taking has enhanced their value is faced with confusion and uncertainty as to the tax treatment of his gain on a potential sale[2]. This uncertainty and lack of uniformity not only

[2] See "Assignment of Income: Fruit and Tree as Irrigated by the P. G. Lake case," 17 Tax Law Review, New York University School of Law, No. 3, March 1962, pp. 293, et seq., at page 346.

impedes the sale of such contractual rights but is bound to create doubts with regard to the making and carrying out of such arrangements.

The conflict among the decisions of the Fifth, Ninth and Second Circuits on this important issue affecting the plans and aspirations of thousands of individuals plainly calls for resolution by this Court.

CONCLUSION

For the reasons stated, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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Attorneys for Petitioners

APPENDIX A

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 20503

LEONARD HYATT and MAUDIE HYATT,
Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of Decision of the Tax Court of the United States (District of Texas).

(December 18, 1963.)

Before HUTCHESON, BREITENSTEIN,* and BELL, Circuit Judges.

PER CURIAM: This case presents a factual situation indistinguishable for the purposes of the controlling legal principle from our decision in *United States* v. *Eidson*, (5th Cir. 1962) 310 F(2) 111. It follows that the decision of the Tax Court, that amounts received by the taxpayers upon assignment of their rights under a general agency contract for a Texas statewide mutual assessment life insurance company were taxable as ordinary income, was correct, and that it should be and is AFFIRMED.

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* Of the Tenth Circuit, sitting by designation.

United States Court of Appeals

FOR THE FIFTH CIRCUIT

October Term, 1963

No. 20503

T. C. No. 72370

LEONARD HYATT and MAUDIE HYATT,
Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of Decision of the Tax Court of the United States (District of Texas).

Before HUTCHESON, BREITENSTEIN,* and BELL, Circuit Judges.

JUDGMENT

This cause came on to be heard on the petition of Leonard Hyatt and Maudie Hyatt for review of a decision of the Tax Court of the United States and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the decision of the Tax Court in this cause be, and the same is hereby, affirmed.

* Of the Tenth Circuit, sitting by designation.

December 18, 1963

Issued as Mandate: Feb. 13, 1964

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 20503

LEONARD HYATT and MAUDIE HYATT,
Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of Decision of the Tax Court of the United States (District of Texas).

(January 31, 1964)

Before HUTCHESON, BREITENSTEIN,* and BELL, Circuit Judges PER CURIAM:

It is ORDERED that the petition for rehearing in the above entitled and numbered cause be and the same is, hereby DENIED.

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* Of the Tenth Circuit, sitting by designation.

APPENDIX B

UNITED STATES of America,

Appellant,

v.

Charles G. EIDSON, Jr., et al., Appellees.

No. 19414.

United States Court of Appeals

Fifth Circuit.

Nov. 30, 1962.

Before TUTTLE, Chief Judge, HUTCHESON, Circuit Judge, and CONNALLY, District Judge.

TUTTLE, Chief Judge.

This appeal by the United States from a judgment entered by the District Court without a jury presents the question whether amounts received by the taxpayers in consideration for the assignment by them of their rights under a management contract which they had with an insurance company are taxable as ordinary income or as capital gains. The appellees contend, and the District Court found, that the assignment by the taxpayers in return for a payment by the assignee of $170,000 constituted a sale or exchange of a capital asset.

The essential facts are not in dispute. American Bankers Life Insurance Company was organized in 1895 under the laws of the State of Texas, and has operated as a statewide mutual assessment life, health and accident insurance company. In the operation of such insurance companies it is advantageous to obtain qualified executives by giving them long term manage-

ment contracts. This was accomplished in this case by the taxpayers here and certain associates who participated with them in all the transactions hereafter related obtaining proxies from a sufficient number of the policyholders of this mutual company so that by voting the proxies they could elect the board of directors consisting of themselves and authorize the execution of a management contract with themselves. No one contends that any question of conflict of interest or anything of the kind in any way vitiates the management contract. This contract gave to Charles G. Eidson and Charles G. Eidson, Jr., Jack L. Eidson, Margaret E. Metz, and J. D. Metz, broad powers as general agents and managers of the life insurance business of American Bankers. In its terms it states that American Bankers "employed" the individuals to do the following things:

> "1. The FIRST PARTY grants to the SECOND PARTY the sole and exclusive General-Agency-Managerial-Service Contract which carries with it the exclusive right to solicit new business and to employ agents for that purpose, subject to the laws of Texas, the regulations of the Insurance Department of Texas, and as may be set forth from time to time by the Directors of the Company. The PARTIES of the SECOND PART shall have the responsibility of the management of the business of the FIRST PARTY as contemplated by the corporate Charter and By-Laws of the Company, — and they shall devote their best efforts to the direction of the affairs and business of the Company."

The contract was for a period of ten years and was subject to renewal by the boards of directors. It was also, by its terms, assignable by the individuals upon

approval of the majority of the board of directors of the company.

Compensation to the managers was determined in the following manner: The Texas state law required that the premiums received from policyholders be placed in two funds — the general fund and the mortuary fund. The general fund was composed of the entire amount of the premiums received during the first year from all policyholders, and 40% of all premiums subsequently received, the remaining 60% of the premiums received in years subsequent to the first policy year going into the mortuary fund. Use of the sums in the mortuary fund was restricted to the payment of justified claims on policies that had been in existence for more than one year, and, to a limited extent, to pay the cost of defending unjustified claims on such policies. The general fund, on the other hand, was required to be used to pay all other expenses of operating American Bankers, the managers being entitled to the balance of the fund, if any, after the payment of all expenses of operation as their profit under the management contract. This contract was made effective January 1, 1952, and continued until July 27, 1955. The managers had continued in management of the affairs of the insurance company as a partnership known as "Charles G. Eidson and Associates." On July 27, 1955, they signed a contract for the benefit of Charles A. McCormick, acting through his transfer agent, Floyd Herring, under which they agreed to transfer (ostensibly) to Herring the management contract with American Bankers for $170,000. The assignment was to be made effective on August 18, 1955. On the same date the directors of Western American Life Insurance Company authorized its officers to acquire by contract with American Bankers the right to

reinsure all of its policyholders, except those designated as Group H,[1] for a payment to American Bankers of $156,000.

On the following date all of the partners of Eidson and Associates resigned their position as officers and directors of American Bankers. However, they elected their successors. The new directors of American Bankers then approved the assignment of the management contract from Eidson and Associates to Herring. Immediately thereafter a new meeting of the board of directors was called and it authorized the execution of the agreement of reinsurance, whereby Western American was to reinsure the policies of American Bankers. The contract was also to become effective on August 18, the date as of which the management contract was to be assigned to Herring. On August 18 the policyholders of American Bankers, apparently acting through Eidson and Associates as proxies, approved the reinsurance agreement; the directors transferred and assigned to Herring all of American Banker's right to receive $156,000 from Western American in return for Herring's relinquishment to American Bankers of all of his right, title and interest in the American Bankers management contract, which he had that day acquired from Eidson and Associates. Thereupon Herring immediately reassigned the right to receive Western American's $156,080 to Eidson and Associates, and delivered a money order for $14,000 to Eidson and Associates, making a total of $170,000, which he had agreed to pay them for the management contract.

[1] Hereafter we will speak of the transfer and the dealings between the parties without references to the exception as to Group H, since this exception has no bearing on the proper resolution of the questions on this appeal.

Thus it is that Western American Insurance Company acquired the policies and business of American Bankers, and eliminated the management arrangement with Eidson and Associates, all as a result of a series of transactions completed on August 18, 1955.

The government has two prongs to its attack on the judgment of the trial court. It says, first, that the management contract, which was assigned to Herring, was not a capital asset, which, if sold or exchanged, would result in a capital gain to the taxpayer, and second, it contends that assuming that the contract rights owned by Eidson and Associates constituted a capital asset there was, nevertheless, no sale or exchange, but rather only a relinquishment by Eidson and Associates of a contractual right in favor of American Bankers Life Insurance Company.

Appellees, on the other hand, join issue as to both grounds, contending that their business enterprise of managing American Bankers was more than a service for a fee; that it was in fact a separate business from American Bankers Life Insurance Company, and that an assignment of it was both a sale or exchange and a sale or exchange of a capital asset.

[1] As we approach a consideration of the basic questions in this case, it is helpful to remember what has many times been made clear by the Supreme Court — it is not every transfer for a consideration of property that gives rise to a capital gain. In Commissioner of Internal Revenue v. Gillette Motor Co., 364 U.S. 130, the Court said at page 134, 80 S.Ct. 1497 at page 1500, 4 L.Ed.2d 1617:

> "While a capital asset is defined in § 117(a)(1) [of the Internal Revenue Code of 1939, the precursor of Section 1221] as 'property held by the

> taxpayer,' it is evident that not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset. This Court has long held that the term 'capital asset' is to be construed narrowly * * *."

Thus, although the contractual right of taxpayer Lake to receive oil payments was undoubtedly property in the common acceptance of the term, the assignment of that right for a cash consideration was held not to give rise to a sale or transfer of a capital asset in Commissioner of Internal Revenue v. P. G. Lake, Inc., 356 U.S. 260, 78 S.Ct. 691, 2 L.Ed. 2d 743. It, therefore, furnishes no answer to our question here to decide that Eidson and Associates had a species of property in their contractual right to manage American Bankers Life Insurance Company on a profitable basis for ten years.

It is also no answer to our problem for the taxpayers here to point to the fact that whatever income they would receive during the life of the management contract would be the result of efforts put forth by them in carrying out their obligations to manage the business. Such was the situation in Roscoe v. Commissioner of Internal Revenue, 5 Cir., 215 F.2d 478, in which this Court affirmed a decision of the Tax Court. That Court found that a payment of some $25,000 to sellers of shares of a corporation's stock was in return for services performed by them or for their cancellation or termination of a partnership agreement with the corporation under which the partnership was to "manage and supervise all details in connection with the subdividing of the said land', and was to have the 'sole and exclusive right' to sell the lots," in return for which service it was entitled to a 10% commission. This

Court held that the cancellation of such a contract involving service for a fee required a holding that the $25,000 payment represented ordinary income rather than a capital gain.

Conceptually, of course, it is difficult to describe any species of property or property rights owned by the taxpayer here that would meet the ordinary definition of a capital asset within the intendment of Section 1221 of the Internal Revenue Code. The Supreme Court has said in Corn Products Refining Co. v. Commissioner of Internal Revenue, 350 U.S. 46, at page 52, 76 S.Ct. 20, at page 24, 100 L.Ed. 29:

> "The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. It was intended 'to relieve the taxpayer from ' * * excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.' Burnet v. Harmel, 287 U.S. [103] at 106 [53 S.Ct. 74, 77 L.Ed. 199]. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term 'capital assets' in § 117. See Hort v. Commissioner of Internal Revenue, 313 U.S. 28, 31 [61 S.Ct. 757, 85 L.Ed. 1168]; Kieselbach v. Commissioner of Internal Revenue, 317 U.S. 399, 403 [63 S.Ct. 303, 87 L.Ed. 358]."

[2] It is, of course, not disputed here by the taxpayers that whatever net amount their contract would yield to them during the remaining life of the contract would be taxable to them as ordinary income. Therefore, if it be deemed, as we think it must, that the sum

of $170,000, which they received for a transfer or assignment of their rights under the contract, represented their agreed amount as to the value of the contract to them, then the $170,000, in a very true sense, represented the present cash value of what would have otherwise been to them income received during the balance of the life of the contract. The fact that, as pointed out by the taxpayers, this income would not be received by the taxpayer unless they performed the services which the contract required of them, that is, actively managed the affairs of the insurance company in a manner that would produce a profit after all of the necessary expenditures, does not, it seems clear, affect the nature of this payment. It affects only the amount. That is, the fact that the taxpayers would have to spend their time and energies in performing services for which the compensation would be received merely affects the price at which they would be willing to assign or transfer the contract. We think, therefore, that the language of the Supreme Court opinion in Commissioner of Internal Revenue v. P. G. Lake, Inc., supra, 356 U.S. at page 266, 78 S.Ct. at page 695, clearly describes the situation before the Court here:

> "The substance of what was assigned was the right to receive future income. The substance of what was received was the present value of income which the recipient would otherwise obtain in the future. In short, consideration was paid for the right to receive future income, not for an increase in the value of the income-producing property."

The significance of the last clause of the quoted language can not be overlooked in light of the repeated statements by the Supreme Court as to the purpose underlying the capital gains provisions of the internal revenue laws. This purpose is reiterated in the Lake

decision, where the Court, at page 265 of 356 U.S., page 694 of 78 S.Ct., says:

> "The purpose of § 117 [the predecessor to the current section] was 'to relieve the taxpayer from * * excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.' See Burnet v. Harmel, 287 U.S. 103, 106 [53 S.Ct. 74, 77 L.Ed. 199]."

Reference to Burnet v. Harmel makes more explicit what "excessive tax burdens" the section was intended to relieve. The Court there said at 287 U.S. 103, 106, 53 S.Ct. 74, 75:

> "Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, *often accruing over long periods of time*, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate, reenacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments * * *." (Emphasis added.)

The Court repeated this thought explicitly in Commissioner of Internal Revenue v. Gillette Motor Co., 364 U.S. 130, where at page 134, 80 S.Ct. 1497 at page 1500 it was said:

> "This Court has long held that the term 'capital asset' is to be construed narrowly in accordance with the purpose of Congress to afford capital gains treatment only in situations typically *involving the realization of appreciation in value accrued over a substantial period of time*, and thus to ameliorate the hardship of taxation of the entire gain in one year. Burnet v. Harmel, 287 U.S. 103,

106, [53 S.Ct. 74, 77 L.Ed. 199]." (Emphasis added.)

The circumstances of the case before us do not, of course, in any way fit this typical definition. The taxpayers had a contract under which they took over control of 40% of all of the premium receipts of American Bankers, spent such amount as was necessary to operate the company, and retained the balance as income to themselves. While, of course, the sum of $170,000 which they received in the taxable year at issue was doubtless much larger than the income they received in any year for a current year's operation, this clearly resulted from the fact that they were assigning, and the assignee was acquiring, not a capital asset whose value had enhanced or accrued over several years, but the right to receive this net profit of operations during the remainder of the life of the contract.

Appellees urge on the Court that our recent decision in Nelson Weaver Mortgage Co. v. Commissioner of Internal Revenue, 5 Cir., 307 F.2d 897, supports their position as to the issue before us here. In that case the taxpayer held a contract with the New York Life Insurance Company, under the terms of which New York Life would buy such mortgages on real estate as it might select from those which had been placed by the taxpayer in a certain specified area in the state of Alabama. On all of such mortgages as were purchased by New York Life from the taxpayer, taxpayer was entitled to a fixed commission. The contract also provided for the payment to the taxpayer of a certain fixed service fee, in return for which it "serviced" the mortgages which had been acquired by New York Life. That is to say it collected the interest payments and principal payments and ascertained whether taxes and insurance were kept current by the mortgagors and the like. In

explaining what species of property was actually transferred by the Nelson Weaver Mortgage Company in that case, the Court said:

> "Cobbs-Allen purchased, therefore, not only the right to service approximately 1,830 mortgages, but it received from Mortgage Company all of the records and files which had been compiled over the years in connection with those mortgage loans. Cf. Rev.Rul. 55-79, 1955-1, Cum. Bull. 370. It obtained also the list of the approximately 1,600 mortgagors who had been the satisfied customers of Mortgage Company and who were figuratively tied to their agent through whom they had dealt through the years. These were a ready-made market, not only for future loans, but as prospects for the sale of homes, lease of apartments, sale of insurance on homes, automobiles and like items. Upon the completion of the sale Mortgage Company severed all connections with this large aggregation of mortgagors and turned over this valuable relationship, with all of its records, to Cobbs-Allen.
>
> "It cannot be doubted that the sum total of the ingredients of this long-standing relationship with such a satisfied clientele constitutes a property right which is the equivalent of good will — the probability that the old customers will resort to the old place. Didlake v. Roden Grocery Co., 160 Ala. 484, 49 So. 384, 22 L.R.A.,N.S., 907 (1909). And it is equally plain that such a property right is a capital asset. [Aaron] Michaels, 12 T.C. 17, 19 (1949) acq. 1949-1 Cum.Bull. 3; [George J.] Aitken et al. 35 T.C. 227 (1960), and Cox (1952), 17 T.C. 1287. And, without dispute, the capital asset here involved had been held more than six months, the economic value having been building up over an eight year period and the contract then in force between Taxpayer and New York Life having been entered into May 5, 1953, prior to the sale on January 29, 1955."

Except to the extent that the Weaver Mortgage Company case can be sustained on the basis that there was there a sale of a property right equivalent to a sale of a business and good will, which really seems to be the ratio decidendi, that case would appear to be in conflict with the earlier Supreme Court decisions defining capital assets. We, therefore, distinguish it on the stated ground that there was a sale of a business including good will, a circumstance not present here.

We next consider the effect on this case of the earlier decision of this Court in Roscoe v. Commissioner of Internal Revenue, supra. As we have pointed out above, the Roscoe case dealt with a sale by taxpayers of 40 shares of stock owned by them in a real estate corporation. In negotiating a sale of their stock, the taxpayers also agreed to cancel a contract which they held from the corporation under which the corporation agreed to subdivide a fifty acre tract into city lots and otherwise improve the property at its own expense, and the taxpayers, as partners, agreed "to manage and supervise all details in connection with the subdividing of said land," and it was to have the "sole and exclusive right" to sell the lots. For this service it was entitled to a 10% commission based on the sale price of the lots. To the extent that the price paid to the taxpayers for their stock exceeded the price which was paid to other stockholders who held no such contract with the corporation, the Tax Court found that the purchase price represented compensation paid to the taxpayers for services or for a cancellation of this contract. This Court affirmed that decision by the Tax Court, and held:

> "If, however, we assume arguendo that the substance of the transaction amounted to the payment of $25,345.41 as consideration for the cancellation

> of the sales contract, that sum was nevertheless ordinary income under Section 22(a) of the Internal Revenue Code, 26 U.S.C.A. § 22(a), and not capital gain under Section 117(a) (4) and (10)."

We conclude that the same principle should apply here. It makes no difference whether the assignment from Eidson and Associates to Herring is to be denominated a "sale" or not. The net and final result of the concurrent transactions was that Eidson and Associates received $170,000 compensation, and as the last of a series of transactions entered into practically simultaneously the management contract was cancelled by American Bankers upon its payment of the amount that ultimately compensated Eidson and Associates for the transfer. Thus, whether on the basis stated by this Court in the Roscoe case or because the property here transferred even if by "sale" is not the class of property which under the concept made clear by the Supreme Court does not constitute a capital asset, we conclude that the trial court erred in permitting a recovery of the tax paid on the ground that it should have been measured as for a capital gain rather than for ordinary income.

The judgment is reversed and the case is remanded for entry of judgment for the appellant.

APPENDIX C

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

Jose FERRER, Respondent.

No. 248, Docket 27232.

United States Court of Appeals
Second Circuit.

Argued April 24, 1962.

Decided June 5, 1962.

Before FRIENDLY, SMITH and MARSHALL, Circuit Judges.

FRIENDLY, Circuit Judge.

This controversy concerns the tax status of certain payments received by Jose Ferrer with respect to the motion picture "Moulin Rouge" portraying the career of Henri de Toulouse-Lautrec. The difficulties Mr. Ferrer must have had in fitting himself into the shape of the artist can hardly have been greater than ours in determining whether the transaction here at issue fits the rubric "gain from the sale or exchange of a capital asset held for more than 6 months," Internal Revenue Code of 1939, § 117(a) (1) and (4), 26 U.S.C.A. § 117(a) (1, 4), as the Tax Court held, 35 T.C. 617 (1961), or constitutes ordinary income, as the Commissioner contends. We have concluded that neither party is entirely right, that some aspects of the transaction fall on one side of the line and some on the other, and that the Tax Court must separate the two.

In 1950 Pierre LaMure published a novel, "Moulin Rouge," based on the life of Toulouse-Lautrec. He then wrote a play, "Monsieur Toulouse," based on the novel. On November 1, 1951, LaMure as "Author" and Ferrer, a famous actor but not a professional producer, as "Manager" entered into a contract, called a Dramatic Production Contract, for the stage production of the play by Ferrer.

The contract was largely on a printed form recommended by the Dramatists Guild of the Authors League of America, Inc. However great the business merits of the document, which are extolled in Burton, Business Practices in the Copyright Field, in C. C. H., 7 Copyright Problems Analyzed (1952) 87, 109, for a court, faced with the task of defining the nature of the rights created, it exemplifies what a contract ought not to be. Its first six pages include eleven articles, some introduced by explanatory material whose contractual status is, to say the least, uncertain. Here the last of these pages was preceded by three single-spaced typewritten pages of "Additional Clauses," one with a still further insert. Finally come 15 pages of closely printed "Supplemental Provisions," introduced by explanatory material of the sort noted. We shall thread our way through this maze as best we can.

By the contract the Author "leased" to the Manager "the sole and exclusive right" to produce and present "Monsieur Toulouse" on the speaking stage in the United States and Canada, and gave certain rights for its production elsewhere. Production had to occur on or before June 1, 1952, unless the Manager paid an additional advance of $1500 not later than that date, in which event the deadline was extended to December 1, 1952. Five hundred dollars were paid as an initial advance against Author's royalties; the Manager was

required to make further advances of like amount on December 1, 1951, and January 1, 1952. Royalties were to be paid the Author on all box-office receipts, on a sliding scale percentage basis.

Article Seventh said that "In the event that under the terms hereof the Manager shall be entitled to share in the proceeds of the Motion Picture and Additional Rights hereafter referred to, it is agreed that the Manager shall receive" 40% for the first ten years and diminishing percentages thereafter. Among the additional rights so described were "Radio and Television."

For the beginning of an answer whether the Manager would be so entitled, we turn to Article IV, § 2, of the Supplemental Provisions. This tells us that "In the event the Manager has produced and presented the play for the 'Requisite Performances and Terms,' the Negotiator shall pay the Manager" the above percentages "of the proceeds, from the disposal of the motion picture rights." Article VI, § 3, contains a similar provision as to payment by the Author of the proceeds of the "additional rights" including radio and television. The "Requisite Performances and Terms" are defined in Article XIII, § 9(b); we shall say more about the "Negotiator" hereafter.

Further provisions put flesh on these bones. Article IV, § 1(a), says that "The title" to the motion picture rights "vests in the Author, as provided in Article VIII hereof." Article VIII says, even more broadly, "The Author shall retain for his sole benefit, complete title, both legal and equitable, in and to all rights whatsoever (including, but not by way of limitation, the Motion Picture Rights * * * Radio and Television Rights * * *)," other than the right to produce the play. The Motion Picture Negotiator, a person appointed by the

Council of the Dramatists Guild, Article V, §§ 1 and 6, has power to dispose of the motion picture rights. However, he may not do this without the written consent of both Author and Manager "prior to the time the play has been playing for any of the respective periods of time referred to in Article XIII, Section 9(b) hereof," Article IV, § 1(b). This prohibition serves a double purpose — it protects the Manager from dilution of the value of the right to produce the play through too early exhibition of a picture, and it promotes realization of the enhancement in the value of the motion picture rights normally resulting from successful dramatic production. Doubtless for similar reasons, the Author could not, without the consent of the Manager, permit the release of radio and television rights until first-class production of the play had ceased. Article V, § 1(b), decrees that the Manager shall "have no right, title or interest, legal or equitable, in the motion picture rights, other than the right to receive the Manager's share of the proceeds * * *" Article V, § 1(c), lays down that if the Manager deems "himself aggrieved by any disposition of motion picture rights, he shall have no recourse, in law or in equity," against a purchaser, a lessee, or the Negotiator; "the Manager's sole recourse * * * shall be against the Author and only by arbitration as provided hereunder." Article V, § 1(d), says it again: "No claim of the Manager, howsoever arising, shall constitute a cloud on the title to the motion picture rights; and a purchaser or lessee thereof shall have the right to deal freely and exclusively with the Author and Negotiator * * *"

Having been somewhat upstaged by these provisions, the Manager then returns toward the center under other clauses. The Negotiator must confer with

him, as well as with the Author, on every step in the disposition of the motion picture rights. "It is desirable that the price shall be mutually satisfactory to both Author and Manager," Article V, § 2(a). If the Manager does not like an offer the Negotiator is planning to accept, he has an opportunity to turn up a better one, ibid. All moneys received for the motion picture rights are to be deposited in a special account, Article V, § 3. An insert to one of the "Additional Clauses" provides that if the Manager desires, the Author, not later than three weeks after the New York opening of the play, will "discuss a proposed deal for the Manager to acquire" the motion picture rights. Finally, another "Additional Clause" prescribes that "All dramatic, motion picture, radio and television rights in the novel MOULIN ROUGE shall merge in and with the play during the existence of this contract," and if the Manager produces and presents the play for a sufficient period, "throughout the copyright period of the play."

Shortly after signature of the Dramatic Production Contract, John Huston called Ferrer to ask whether he would be interested in playing Toulouse-Lautrec in a picture based upon "Moulin Rouge." On getting an affirmative indication, Huston said he would go ahead and acquire the motion picture rights. Ferrer replied, in somewhat of an exaggeration, "When you get ready to acquire them talk to me because I own them."

Both Huston and Ferrer then had discussions with LaMure. Ferrer expressed a willingness "to abandon the theatrical production in favor of the film production, provided that, if the film production were successful, I would be recompensed for my abandoning the stage production." On the strength of this, LaMure

signed a preliminary agreement with Huston's corporation. In further negotiations, Huston's attorney insisted on "either an annulment or conveyance" of the Dramatic Production Contract. LaMure's lawyer prepared a letter of agreement, dated February 7, 1952, whereby Ferrer would cancel and terminate the Contract. Ferrer signed the letter but instructed his attorney not to deliver it until the closing of a contract between himself and the company that was to produce the picture; the letter was not delivered until May 14, 1952.

Meanwhile, on May 7, 1952, Ferrer entered into a contract with Huston's company, Moulin Productions, Inc. ("Moulin"), hereafter the Motion Picture Contract. This was followed by an agreement and assignment dated May 12, 1952, whereby LaMure sold Huston all motion picture rights to his novel, including the right to exploit the picture by radio and television. Under this agreement LaMure was to receive a fixed sum of $25,000, plus 5% and 4% of the Western and Eastern Hemisphere motion picture profits, respectively, and 50% of the net profits from exploitation by live television.

The Motion Picture Contract said that Romulus Films Limited, of London, proposed to produce the picture "Moulin Rouge," that Moulin would be vested with the Western Hemisphere distribution rights, and that Moulin on behalf of Romulus was interested in engaging Ferrer's service to play the role of Toulouse-Lautrec. Under clause 4(a), Ferrer was to receive $50,000 to cover 12 weeks of acting, payments to be made weekly as Ferrer rendered his services. Ferrer's performance was to begin between June 1 and July 1, 1952. By clause 4(b), Ferrer was to receive $10,416.66

per week for each additional week, but this, together with an additional $50,000 of salary provided by clause 4(c), was "deferred and postponed" and was payable only out of net receipts. Finally, clauses 4(d) and (e) provided "percentage compensation" equal to stipulated percentages of the net profits from distribution of the picture in the Western and Eastern Hemispheres respectively — 17% of the Western Hemisphere net profits until Ferrer had received $25,000 and thereafter 12¾% (such payments to "be made out of sixty-five (65%) percent of the net profits," whatever that may mean), and 3¾% of the Eastern Hemisphere net profits. If Ferrer's services were interrupted by disability or if production of the picture had to be suspended for causes beyond Moulin's control, but the picture was thereafter completed and Ferrer's "acts, poses and appearances therein" were recognizable to the public, he was to receive a proportion of the compensation provided in clauses 4(c), (d) and (e) corresponding to the ratio of his period of acting to 12 weeks. The same was true if Ferrer failed to "conduct himself with due regard to public conventions and morals" etc. and Moulin cancelled on that account. The absence of any similar provision with respect to termination for Ferrer's wilful refusal or neglect to perform services indicates that all his rights, except that for compensation already due under clause 4(a), would be forfeited in that event. Over objections by the Commissioner, Ferrer offered testimony by Huston's attorney, who was also president of Moulin, that in the negotiation "it was said that the ultimate percentage payment to be made to Ferrer would be his compensation for giving up his interest in the dramatization guild," and a letter from the same attorney, dated March 3, 1953, confirming that in the negotiations with Ferrer's attorney "for the sale of the dramatic

rights held by you to the property entitled 'MONSIEUR TOULOUSE' and the novel 'MOULIN ROUGE,' it was understood that the consideration for such sale price was the payments due, or to become due, to you under Clause 4(d) and Clause 4(e)," and also that LeMure "refused to sell the motion picture rights for the production of the motion picture known as 'MOULIN ROUGE' unless you sold the aforesaid dramatic rights." Ferrer's agent testified, again over objection, that the largest salary Ferrer had previously received for a moving picture appearance was $75,000.

Moulin's books showed $109,027.74 as a salary payment to Ferrer in August, 1953, and $178,751.46 at various later dates in 1953 as the payment of "Participating Interests" under clause 4(d).[1] Ferrer's 1953 return reported the former as ordinary income, and the latter, less expenses of $26,812.72,[2] as a long-term capital gain. The Commissioner determined a deficiency on the basis that the difference, $151,938.74, constituted ordinary income; from the Tax Court's annulment of that determination he has taken this appeal.

[1] Section 117(a) of the 1939 Code, now § 1221 of the 1954 Code, 26 U.S.C.A. § 1221, tells us, not very illuminatingly, that " 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include" four (now five) types of property therein defined. However, it has long been settled that a taxpayer does not bring himself within the capital gains provision merely by

1 The record is silent on payments for Eastern Hemisphere profits under clause 4(e), or on whether there will be further payments for Western Hemisphere profits under clause 4(d); we suppose both these will come in later years.

2 The record does not disclose the nature of these expenses, but the Commissioner has not questioned them.

fulfilling the simple syllogism that a contract normally constitutes "property," that he held a contract, and that his contract does not fall within a specified exclusion, C. I. R. v. Gillette Motor Transport, Inc., 364 U.S. 130, 134-135, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960); Surrey, Definitional Problems in Capital Gains Taxation, 69 Harv. L.Rev. 985, 988 (1956). This is easy enough; what is difficult, perhaps impossible, is to frame a positive definition of universal validity. Attempts to do this in terms of the degree of clothing adorning the contract cannot explain all the cases, however helpful they may be in deciding some, perhaps even this one; it would be hard to think of a contract more "naked" than a debenture, yet no one doubts that is a "capital asset" if held by an investor. Efforts to frame a universal negative, e.g., that a transaction can never qualify if the taxpayer has merely collapsed anticipation of future income, are equally fruitless; a lessor's sale of his interest in a 999 year net lease and an investor's sale of a perpetual bond sufficiently illustrate why, as does Ayrton Metal Co. v. C. I. R., 299 F.2d 741 (2 Cir. 1962).

Perhaps we can get more help from analyzing the fact situations in cases in adjacent areas, including those decided since Judge Smith's careful review in C. I. R. v. Pittston Company, 252 F.2d 344 (2 Cir.), cert. denied, 357 U.S. 919, 78 S.Ct. 1360, 2 L.Ed.2d 1361 (1958), than from the language of the opinions. Putting aside Jones v. Corbyn, 186 F.2d 450 (10 Cir. 1950), which we have disapproved, C. I. R. v. Starr Bros., Inc., 204 F.2d 673, 674 (2 Cir. 1953) and whose status in its own circuit has now become rather doubtful, Wiseman v. Halliburton Oil Well Cementing Co., 301 F.2d 654, (10 Cir. 1962), a case to which we refer below, and C. I. R. v. Goff, 212 F.2d 875 (3 Cir.), cert.

denied, 348 U.S. 829, 75 S.Ct. 52, 99 L.Ed. 654 (1954), which is only dubiously reconcilable with our Pittston decision, the principal relevant authorities on the two sides of the line in the Supreme Court and in the courts of appeals are as follows: There is no sale or exchange of a capital asset when a lessor receives payment for releasing a lessee from an obligation to pay future rent, Hort v. C. I. R., 313 U.S. 28, 61 S.Ct. 757, 85 L.Ed. 1168 (1941). The same was true of the cancellation of an exclusive distributorship, C. I. R. v. Starr Bros., Inc., 204 F.2d 673 (2 Cir. 1953); Leh v. C. I. R., 260 F.2d 489 (9 Cir. 1958), although § 1241 of the 1954 Code, 26 U.S.C.A. § 1241 now rules otherwise if the distributor has a substantial capital investment therein. The transfer of exclusive agency rights to a third person likewise did not qualify, General Artists Corp. v. C. I. R., 205 F.2d 360 (2 Cir.), cert. denied, 346 U.S. 866, 74 S.Ct. 105, 98 L.Ed. 376 (1953); whether it now does if the capital investment requirement of § 1241 is met is another question. The sale of oil payment rights, C. I. R. v. P. G. Lake, Inc., 356 U.S. 260, 78 S.Ct. 691, 2 L.Ed.2d 743 (1958), the temporary taking of a taxpayer's right to use his own transportation assets, C. I. R. v. Gillette Motor Transport, Inc., supra, and the surrender of an exclusive contract to purchase coal, C. I. R. v. Pittson Co., supra, do not meet the statutory test. Neither does the receipt of a lump sum in liquidation of a percentage of the gross receipts of motion pictures otherwise payable to a producer solely in return for personal services not yet performed, Holt v. C. I. R., 303 F.2d 687 (9 Cir. 1962). On the other hand, a lessee's surrender of his lease to the lessor, C. I. R. v. Golonsky, 200 F.2d 72 (3 Cir. 1952), cert. denied, 345 U.S. 939, 73 S.Ct. 830, 97 L.Ed. 1366 (1953); C. I. R. v. McCue Bros. & Drummond, Inc., 210 F.2d 752 (2 Cir.), cert. denied, 348 U.S. 829, 75

S.Ct. 53, 99 L.Ed. 654 (1954), now in effect ratified by § 1241 of the 1954 Code, his relinquishment of a right to restrict the lessor's renting to another tenant in the same business, C. I. R. v. Ray, 210 F.2d 390 (5 Cir.), cert. denied, 348 U.S. 829, 75 S.Ct. 53, 99 L.Ed. 654 (1954), and his release of his entire interest to a sublessee, Metropolitan Bldg. Co. v. C. I. R., 282 F.2d 592 (9 Cir. 1960), but see Voloudakis v. C. I. R., 274 F.2d 209 (9 Cir. 1960), constitute the sale or exchange of a capital asset. So does the abandonment of an option to acquire a partnership interest, Dorman v. United States, 296 F.2d 27 (9 Cir. 1961).

[2, 3] One common characteristic of the group held to come within the capital gain provision is that the taxpayer had either what might be called an "estate" in (Golonsky, McCue, Metropolitan), or an "encumbrance" on (Ray), or an option to acquire an interest in (Dorman), property which, if itself held, would be a capital asset. In all these cases the taxpayer had something more than an opportunity, afforded by contract, to obtain periodic receipts of income, by dealing with another (Starr, Leh, General Artists, Pittston), or by rendering services (Holt), or by virtue of ownership of a larger "estate" (Hort, P. G. Lake). We are painfully aware of the deficiencies of any such attempt to define the wavering line even in this limited area, but it is the best we can do. We add, with greater confidence, that more recent cases, such as McCue & Drummond, Ray, Metropolitan, and Dorman, have moved away from the distinction, relied upon to some

extent in Starr Brothers and General Artists,[3] between a sale to a third person that keeps the "estate" or "encumbrance" alive, and a release that results in its extinguishment.[4] Indeed, although reasoning from another section of a statute so full of anomalies is rather treacherous business, we take § 1241 of the 1954 Code as indicating Congressional disenchantment with this formalistic distinction. In the instant case we can see no sensible business basis for drawing a line between a release of Ferrer's rights to LaMure for a consideration paid by Moulin, and a sale of them, with LaMure's consent, to Moulin or to a stranger who would then release them. Moulin's attorney, as we have seen, did not care a fig whether there was "an annulment or conveyance" of the Dramatic Production Contract. Tax law is concerned with the substance, here the voluntary passing of "property" rights allegedly constituting "capital assets," not with whether they are passed to a stranger or to a person already having a larger "estate." So we turn to an analysis of what rights Ferrer conveyed.

Two issues can be eliminated before we do this. We need no longer concern ourselves, as at one time we might have been obliged to do, over the alleged indivisibility of a copyright; the Commissioner is now satisfied that sales and exchanges of less than the whole copyright may result in capital gain, Rev.Rul. 60-226,

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[3] These cases could well have been decided on the basis that the taxpayer held only a contract right giving him an opportunity to earn future income.

[4] We say this despite certain language in Lén v. C. I. R., 260 F.2d 489 (9 Cir. 1958) and in Holt v. C. I. R., 303 F.2d 687 (9 Cir. 1962), both of which, like the cases referred to in footnote 3, validly rested on the absence of a "capital asset."

1960-1 Cum.Bull. 26. See also Gitlin & Woodward, Tax Aspects of Patents, Copyrights and Trademarks (1960 rev.) 18-19; Sargoy, Formalities and Ownership, 9 Bull.Cr.Soc. 20, 43 (1961); Surrey & Warren, Federal Income Taxation, Cases and Materials (1960) 753. Neither do we have in this case any issue of excludability under § 117(a) (1) (A), now § 1221 (1); Ferrer was not in the "trade or business" of acquiring either dramatic production rights or motion picture rights.

When Huston displayed an interest in the motion picture rights in November, 1951, Ferrer was possessed of a bundle of rights, three of which are relevant here. First was his "lease" of the play. Second was his power, incident to that lease, to prevent any disposition of the motion picture rights until June 1, 1952; or, on making an additional $1500 advance, to December 1, 1952, and for a period thereafter if he produced the play, and to prevent disposition of the radio and television rights even longer. Third was his 40% share of the proceeds of the motion picture and other rights if he produced the play. All these, in our view, Ferrer "sold or exchanged," although the parties set no separate price upon them. To be sure, Moulin had no interest in producing the play. But Ferrer did, unless a satisfactory substitute was provided. Hence Moulin had to buy him out of that right, as well as to eliminate his power temporarily to prevent a sale of the motion picture, radio and television rights and to liquidate his option to obtain a share of their proceeds.

[4, 5] (1) Surrender of the "lease" of the play sounds like the transactions held to qualify for capital gain treatment in Golonsky and McCue Bros. & Drummond, see § 1241 of the 1954 Code. Such cases as Wooster v. Crane & Co., 147 F.515 (8 Cir. 1906), Underhill v. Schenck, 238 N.Y. 7, 143 N.E. 773, 33 A.L.R. 303 (1924), and Kirke La Shelle Co. v. Paul Armstrong Co., 263 N.Y. 79, 188 N.E. 163 (1933) are *a fortiori* authority that courts would have enjoined LaMure, or anyone else, from interfering with this, unless the Dramatic Production Contract dictated otherwise. None of its many negations covered this basic grant. Ferrer thus had an "equitable interest" in the copyright of the play.

The Commissioner did not suggest in the Tax Court, and does not here, that this interest or, indeed, any with which we are concerned in this case, fell within § 117(a) (1) (C) of the 1939 Code, now § 1221(3), excluding from the term "capital asset" " a copyright; a literary, musical, or artistic composition; or similar property; held by—

> "(i) a taxpayer, whose personal efforts created such property * * *."

He was right in not doing this. In one sense the lease of the play was "created" simply by the agreed advance of $1500. If it be said that this is too narrow an approach and that we must consider what Ferrer would have had to do in order to make the lease productive, the result remains the same. Although the Dramatic Production Contract demanded Ferrer's personal efforts in the play's production, much else in the way of

capital and risk-taking was also required. Yet the legislative history, see S.Rep. No. 2375, 81st Cong., 2d Sess., printed in 2 U.S.Code Cong.Serv. p. 3053 (1950), shows that § 117(a) (1) (C), initially added by the Revenue Act of 1950, 64 Stat. 906, 933, was intended to deal with personal efforts and creation in a rather narrow sense.[5] See Stern v. United States, 164 F.Supp. 847, 851 (E.D.La. 1958), aff'd per curiam, 262 F.2d 957 (5 Cir.), cert. denied, 359 U.S. 969, 79 S.Ct. 880, 3 L.Ed.2d 836 (1959); McPeters, Taxation of Literary Property Income, 12 Mercer L.Rev. 370, 375-380 (1961); and Rev. Rul. 55-706, 1955-2 Cum.Bull. 300. Ferrer's role as producer, paying large sums to the theatre, the actors, other personnel, and the author, is not analogous to that of the writer or even the "creator" of a radio program mentioned by the Committee. Moreover, the dramatic producer does not normally "sell" the production to a single purchaser, as an author or radio program "creator" usually does —he offers it directly to public custom.

[5] The Committee introduced its discussion by referring to persons "in the profession of writing books, or creating other artistic works." It then discussed the previous law, whereby an "amateur" can sell "his book or other artistic work" after holding it for 6 months, and thereby receive "long-term capital gain treatment on the product of his personal effort," p. 3097. The bill therefore provided "that when any person sells a book or other artistic work which is the product of his personal effort his income from the sale is taxed as ordinary income." At p. 3140, the Committee characterized its handiwork as follows:

"Under the committee amendment, a person who writes a book or creates some other sort of artistic work will be taxed at ordinary income rates, rather than at capital-gain rates, upon gain from the sale of the work regardless of whether it is his first production in the field or not. The amendment made by section 215(a) will also exclude from the capital asset category any property similar to that specifically named; for example, a radio program which has been created by the personal efforts of the taxpayer * * * The interest of a sole proprietor in such a business enterprise as a photographic studio is not 'similar property' even though the value of the business may be largely attributable to the personal efforts of the sole proprietor."

[6, 7] We see no basis for holding that amounts paid Ferrer for surrender of his lease of the play are excluded from capital gain treatment because receipts from the play would have been ordinary income. The latter is equally true if a lessee of real property sells or surrenders a lease from which he is receiving business income or subrentals; yet Golonsky and McCue Bros. & Drummond held such to be the sale or exchange of a capital asset, as § 1241 now provides. Likewise we find nothing in the statute that forbids capital gain treatment because the payment to Ferrer might be spread over a number of years rather than coming in a lump sum; although prevention of the unfairness arising from applying ordinary income rates to a "bunching" of income may be one of the motivations of the "capital gain" provisions, the statute says nothing about this. Compare Burnet v. Logan, 283 U.S. 404, 51 S.Ct. 550, 75 L.Ed. 1143 (1931). Finally, with respect to the lease of the play, there was no such equivalence between amounts paid for its surrender and income that would have been realized by its retention as seems to lie at the basis of the Tenth Circuit's recent refusal of capital gain treatment in Wiseman v. Halliburton Oil Well Cementing Co., 301 F.2d 654 (1962), a decision as to which we take no position.

(2) Ferrer's negative power, as an incident to the lease, to prevent any disposition of the motion picture, radio and television rights until after production of the play, was also one which, under the cases previously cited, as well as Harper Bros. v. Klaw, 232 F. 609, 613 (S.D.N.Y. 1916) and Manners v. Morosco, 252 U.S. 317, 40 S.Ct. 335, 64 L.Ed. 590 (1920), would be protected in equity unless he had contracted to the contrary, and would thus constitute an "equitable interest" in this portion of the copyright. Although we

should not regard Articles IV, § 1(a) and VIII as outlawing equitable relief to protect the rights granted as to the play, a literal reading of Article V, § 1(c), quoted above, would negate Ferrer's power to enjoin disposition of the motion picture rights prior to production of the play and would remit him to arbitration —a consequence serious from the standpoint of definition of a capital asset, especially in view of the emphasis we placed in Pittston, 252 F.2d at 348, on the unavailability of injunctive relief there. In the absence of authority, we should not read the clause so broadly; we would construe it as relating to disputes as to the manner of disposition of the rights after the Negotiator had become entitled to dispose of them, not as closing the door on the only effective method for protecting the Manager's important interest against premature disposition. As a practical matter, this feature of the Dramatic Production Contract "clouded" LaMure's title, despite the Contract's contrary assertion. Huston would not conclude with LaMure and LaMure would not conclude with Huston unless Ferrer released his rights; Huston's attorney testified that a contract like Ferrer's "imposes an encumbrance on the motion picture rights." Ferrer's dissipation of the cloud arising from the negative covenant seems analogous to the tenant's relinquishment of a right to prevent his landlord from leasing to another tenant in the same business, held to be the sale or exchange of a capital asset in Ray. What we have said in (1) with respect to possible grounds for disqualification as a capital asset is *a fortiori* applicable here.

(3) We take a different view with respect to the capital assets status of Ferrer's right to receive 40% of the proceeds of the motion picture and other rights if he produced "Monsieur Toulouse."

We assume, without deciding, that there is no reason in principle why if the holder of a copyright grants an interest in the portion of a copyright relating to motion picture and other rights contingent on the production of a play, or, to put the matter in another way, gives the producer an option to acquire such an interest by producing the play, the option would not constitute a "capital asset" unless the producer is disqualified by § 117(a) (1) (A), now § 1221(1). Although the copyright might not be such an asset in the owner's hands because of that section or § 117(a) (1) (C) (i), now § 1221(3) (A), the latter disqualification would not apply to the producer for reasons already discussed, and the former would not unless the producer was a professional. However, it is equally possible for the copyright owner to reserve the entire "property" both legal and equitable in himself and agree with the producer that a percentage of certain avails shall be paid as further income from the lease of the play — just as the lessor of real estate might agree to pay a lessee a percentage of what the lessor obtained from other tenants attracted to the building by the lessee's operations. In both instances such payments would be ordinary income. If the parties choose to cast their transaction in the latter mold, the Commissioner may take them at their word.

Here the parties were at some pains to do exactly that. LaMure was to "retain for his sole benefit, complete title, both legal and equitable, in and to all rights whatsoever" other than the right to produce the play. Ferrer was to "have no right, title or interest, legal or equitable, in the motion picture rights, other than the right to receive the Manager's share of the proceeds"; even as to that, he was to have "no recourse, in law or in equity" against a purchaser, a lessee, or the Negoti-

ator, but only a right to arbitration against the Author. We cannot regard all this as mere formalism. The Contract is full of provisions designed to emphasize the Negotiator's freedom to act — provisions apparently stemming from a fear that, without them, the value of the motion picture rights might disintegrate in controversy. McClintic v. Sheldon, 269 App.Div. 356, 55 N.Y.S.2nd 879 (1st Dept. 1945), aff'd, 295 N.Y. 682, 65 N.E.2d 328 (1946), greatly relied upon by the taxpayer, does not show that, despite the contrary language of the Contract, Ferrer had, or ever would have, an affirmative equitable interest in the motion picture or other rights, as distinguished from his temporary negative "encumbrance" on them. Although the Appellate Division's opinion contains some remarks as to the equitable interest of a licensee in a copyright, these were not essential to the holding, namely, that "the clear language" of the agreement entitled the producer to the moneys there in question. Moreover, examination of the papers on appeal shows that the contract between the producer and the author in that case was an earlier form not containing the extensive negation of equitable property interests present here.[6]

It follows that if Ferrer had produced the play and LaMure had sold the motion picture, radio and television rights for a percentage of the profits, Ferrer's 40% of that percentage would have been ordinary income and not the sale or exchange of a capital asset. The decisions in Hort and Holt point to what would seem the inevitable corollary that if, on the same facts, Ferrer had then sold his rights to a percentage of the

[6] The "Additional Clause" summarized at the end of our analysis of the Dramatic Production Contract does not call for a different conclusion, as Ferrer urges. This simply protected Ferrer against LaMure's dealing with the novel without regard to Ferrer so long as LaMure did not deal with the play; the clause did not alter the character of Ferrer's rights with respect to LaMure's copyright.

profits for a lump sum, that, too, would have been ordinary income, see Herman Shumlin, 16 T.C. 407 (1951). The situation cannot be better from Ferrer's standpoint because he had merely a contingent right to, or an option to obtain, the 40% interest; the case differs from Dorman v. United States, supra, in that there the option was to acquire what would admittedly have been a "capital asset."

The situation is thus one in which two of the rights that Ferrer sold or exchanged were "capital assets" and one was not. Although it would be easy to say that the contingent contract right to a percentage of the avails of the motion picture, radio and television rights was dominant and all else incidental, that would be viewing the situation with the inestimable advantage of hindsight. In 1952 no one could tell whether the play might be a huge success and the picture a dismal failure, whether the exact opposite would be true, whether both would succeed or both would fail. We cannot simply dismiss out of hand the notion that a dramatic production, presenting an actor famous on the speaking stage and appealing to a sophisticated audience, might have had substantial profit possibilities, perhaps quite as good as a film with respect to a figure, not altogether attractive and not nearly so broadly known then as the success of the picture has made him now, which presumably would require wide public acceptance before returning production costs. At the very least, when Ferrer gave up his lease of the play, he was abandoning his bet on two horses in favor of a bet on only one.

[8, 9] In such instances, where part of a transaction calls for one tax treatment and another for a different kind, allocation is demanded, Helvering v.

Taylor, 293 U.S. 507, 55 S.Ct. 287, 79 L.Ed, 623 (1935); Ditmars v. C. I. R., 302 F.2d 481 (2 Cir. 1962). If it be said that to remand for this purpose is asking the Tax Court to separate the inseparable, we answer that no one expects scientific exactness; that however roughly hewn the decision may be, the result is certain to be fairer than either extreme; and that similar tasks must be performed by the Tax Court in other areas, see Webster Investors, Inc. v. C. I. R., 291 F.2d 192 (2 Cir. 1961); Meister v. C. I. R., 302 F.2d 54 (2 Cir. 1962) [determination of portion of purchase price attributable to good-will].

Still we have not reached the end of the road. The Commissioner contends that, apart from all else, no part of the payments here can qualify for capital gain treatment, since Ferrer could receive "percentage compensation" only if he fulfilled his acting commitments, and all the payments were thus for personal services. Citing C. I. R. v. Dwight's Estate, 205 F.2d 298, 301 (2 Cir.), cert. denied, 346 U.S. 871, 74 S.Ct. 121, 98 L.Ed. 380 (1953), the Commissioner says it was error for the Tax Court to rely on extrinsic evidence to vary the written contract.

Although the parties have taken opposing positions on the applicability of the "parol evidence rule" to a dispute involving a stranger to the contract, a question discussed by Professor Corbin in his usual illuminating fashion in 3 Contracts (rev.ed. 1960) § 596, cf. 9 Wigmore, Evidence (3d ed. 1940) § 2446, at p. 150, and see, with respect to tax controversies, Stern v. C. I. R., 137 F.2d 43, 46 (2 Cir. 1943); Scofield v. Greer, 185 F.2d 551, 552 (5 Cir. 1950); Landa v. C. I. R., 92 U.S.App.D.C. 196, 206 F.2d 431, 432 (1953); Mustard v. United States, 155 F.Supp. 325, 332 (Ct.Cl.1957);

Thorsness v. United States, 260 F.2d 341, 345 (7 Cir. 1958); Cooper Foundation v. O'Malley, 121 F.Supp. 438, 444 (D.Neb.1954), no such issue is here presented. No one argued the contract provided anything other than what was plainly said. Huston's attorney did not assert that Ferrer would become entitled to the percentage compensation without fulfilling his acting commitment; what the attorney said in his testimony, as he had earlier in his letter, was that Ferrer was selling two things to Moulin — his services as an actor and his rights under the Dramatic Production Contract — and that the parties regarded the payments under clauses 4(a), (b) and (c) as the consideration for the former and those under clauses 4(d) and (e) as the consideration for the latter.

[10] On the basis of this evidence the Tax Court found that the percentage compensation was not "to any extent the consequence of, or consideration for, petitioner's personal services." In one sense, this is hardly so. Under the Motion Picture Contract, Ferrer would receive no percentage compensation if he wrongfully refused to furnish acting services, and none or only a portion if, for reasons beyond his control, he furnished less than all. Since that must have been as plain to the Tax Court as to us, we read the finding to mean rather that Ferrer and Moulin adopted the percentage of profits formula embodied in clauses 4(d) and (e) as an equivalent and in lieu of a fixed sum payable in all events for the release of the Dramatic Production Contract. If they had first agreed on such a sum and had then substituted the arrangement here made, it would be hard to say that although payments under their initial arrangement would not be disqualified for capital gain treatment, payments under the substituted one would be. Ferrer was already bound to play the role of Toulouse-Lautrec, at a salary implicitly

found to constitute fair compensation for his services; adoption of a formula whereby his receipt of percentage compensation for releasing his rights was made contingent on his fulfilling that undertaking does not mean that the percentage compensation could not be solely for his release of the Contract. The Tax Court was not bound to accept the testimony that this was the intent—it could lawfully have found that the percentage compensation was in part added salary for Ferrer's acting services and in part payment for the release. However, it found the contrary, and we cannot say that in doing so it went beyond the bounds to which our review of its fact findings is confined, Internal Revenue Code of 1954, § 7482(a), 26 U.S.C.A. § 7482 (a); F.R.Civ.Proc. 52(a). Since, on the taxpayer's own evidence, the percentage compensation was for the totality of the release of his rights under the Dramatic Production Contract, allocation is required as between rights which did and rights which did not constitute a "capital asset."

We therefore reverse and remand to the Tax Court to determine what portion of the percentage compensation under clauses 4(d) and (e) of the Motion Picture Contract constituted compensation for Ferrer's surrendering his lease of the play and his incidental power to prevent disposition of the motion picture and other rights pending its production, as to which the determination of deficiency should be annulled, and what part for the surrender of his opportunity to receive 40% of the proceeds of the motion picture and other rights as to which it should be sustained. The expenses allowed as basis must likewise be allocated. Doubtless further evidence will have to be taken unless the parties can reach some practical adjustment.

It is so ordered.

APPENDIX D

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 20018

UNITED STATES OF AMERICA,

Appellant,

versus

DRESSER INDUSTRIES, INC.,

Appellee.

Appeal from the United States District Court for the Northern District of Texas.

(November 6, 1963.)

Before CAMERON and BROWN, Circuit Judges, and WHITEHURST, District Judge.

CAMERON, Circuit Judge: This case involves the question whether money received by the taxpayer[1]

[1] Appellee Dresser Industries, Inc. has succeeded to the claims of its two predecessor corporations. For convenience, it being undisputed that whatever rights there may be now lie in Dresser, we will refer to the corporations simply as "taxpayer."

The years involved are 1953, 1954, 1955 and 1956.

qualifies for capital gains treatment. The court below held for the taxpayer, awarding judgment in the amount of some ninety thousand dollars, and the government appeals.

The facts underlying this controversy are not in material dispute, most of them being stipulated. Taxpayer owned two patents relating to radioactivity oil well surveying. Well-Surveys, Inc., another party, owned certain patent rights relating to a method and apparatus for logging oil wells. In 1942, it developed a new well surveying method called "Neutron-Gamma Ray Well-Logging."

In 1940, Well-Surveys and taxpayer entered into an agreement whereby Well-Surveys granted to taxpayer a license to practice its patent for others, for hire. The agreement described the license given as exclusive, but exempted licenses which had been previously granted to others, and reserved to Well-Surveys the right to practice the patent for hire. Taxpayer agreed to pay to Well-Surveys one-quarter of any fees earned from practice of the patent, and Well-Surveys acquired the right to practice certain of taxpayers' patents. In 1942, the new patent was included in the agreement.

In 1957, Well-Surveys and taxpayer entered into a new agreement. Taxpayer no longer possessed the "exclusive" feature of the grant, and in return Well-Surveys agreed to pay to taxpayer the sum of five hundred thousand dollars, to be paid out of one quarter of the fees earned by practice of the patent to third

parties. The sums paid taxpayer under this arrangement are the subject matter of this tax refund action, taxpayer having paid taxes as ordinary income on such sums received, and having brought this action claiming that capital gains treatment was due.

The government contends, first, that the right assigned or transferred in 1957 was not "property" or a "capital asset", but was "nothing more than a substitute for ordinary income to the 'selling' party;" and, second, that "even assuming *arguendo* that a capital asset was here involved, there was no sale or exchange of that asset."

Appellee taxpayer, of course, argues that the *exclusive* right to practice the patent for hire was a capital asset, and that there was a sale or exchange, inasmuch as, at the moment of sale, it had the right and no money and, after the "sale," it had no exclusive right and a claim of money.[2]

The government makes the customary broadside attack on the sale by citing the usual three cases: *Corn Products Co. v. Commissioner*, 1955, 350 U.S. 46; *Commissioner v. P. G. Lake, Inc.*, 1958, 356 U.S. 260; *Commissioner v. Gillette*, 1960, 364 U.S. 130, attempting to demonstrate that their holdings are dispositive of this case. As we did in *Nelson Weaver Realty Co. v. Commissioner*, 1962, 5 Cir., 307 F.2d 897, we will distinguish those cases at the threshold:

[2] Taxpayer relies also on 26 U.S.C.A. § 117(j) (I.R.C. 1939) extending capital gains treatment to depreciable trade or business property. We need not discuss this section, however, as our disposition turns on an interpretation of 26 U.S.C.A. § 117(a)(1).

> "In *Corn Products* . . . the Tax Court, . . . the Court of Appeals, . . . and the Supreme Court found specifically that the taxpayer regularly dealt in corn futures as part of its everyday business operations and that they were, judicially, excluded from the definition of capital assets." *Nelson Weaver, supra*, at p. 902.

The taxpayer here did not, by any stretch of the imagination, deal regularly with the sale of well surveying patents.

> "In *Commissioner v. P. G. Lake, Inc.*, . . . the taxpayer received from the sale of an oil payment an amount exactly equal to the 'face value' of the oil payment transferred, which was expected to and did pay out in slightly more than three years. The interest transferred to the assignee was to terminate after the assignee had received the $600,000.00, the interest which was assigned, plus an amount equal to three percent on the unpaid balance. The seller kept a reversionary interest in the property sold, the purchaser received nothing but a right to payments, which right was to terminate as soon as the $600,000.00 plus three percent interest was paid. What was sold, therefore, was the right to receive money in the future, the sales price being almost the exact equivalent of the income which was to be produced in the future." *Nelson Weaver, supra*, at p. 902.

The taxpayer here is cutting off a "vertical slice" of its rights, rather than carving out an interest from the totality of its rights under the grant. The interest transferred was not to terminate when a certain amount was paid, as was so in *Lake*, and taxpayer retained no reversionary interest in the "exclusivity" feature transferred. The tree was sold, along with the fruit, at least insofar as that branch was concerned. *Cf.* "Assignment of Income: Fruit and Tree as Irrigated by the P. G. Lake Case," 17 Tax Law Review, New York University School of Law, No. 3, March 1962, pp. 293 et seq.

> "*Gillette Motor Co.*, . . . involved the question whether the amount received by it as compensation for the temporary taking by the Government of its business facilities for a period of about ten months during World War II constituted ordinary income or capital gain. . . .
>
> "The Motor Carrier Claims Commission allowed in this and all similar cases the fair market value of what was taken, which it held to be nothing more than the use of the facilities entitling Gillette to the fair rental value with interest. . . ." *Nelson Weaver, supra*, at p. 903.

The temporary taking by the government of private facilities merely produced what was, in effect, *rent* which is usually considered ordinary income. The transfer involved here was permanent and final.

The government did not, below, raise the first point, that is, that the gain is anticipated future income, and cannot raise it here on appeal for the first time. *Nelson*

Weaver at page 903, fn. 6. But we feel that the broad assertion made that, in any case where the purchase price includes anticipated income there can be no capital gains treatment, must be answered. Another panel of this Court, in the case of *United States v. Eidson*, 1962, 5 Cir., 310 F.2d 111,[3] accepted literally the Supreme Court's generalization in *Lake, supra*, p. 266: "The substance of what was assigned was the right to receive future income. The substance of what was received was the present value of income which the recipient would otherwise obtain in the future. In short, consideration was paid for the right to receive future income, not for an increase in the value of the income-producing property", to mean that any money paid which represents the present value of future income to be earned is always taxed as ordinary gains. As a legal or economic position, this cannot be so. The only commercial value of any property is the present worth of future earnings or usefulness. If the expectation of earnings of stock rises, the market value of the stock may rise; at least a part of this increase in price is attributable to the expectation of increased income. The value of a vending machine, as metal and plastic, is almost nil; its value arises from the fact that it will produce income.

At common law, the right to receive income from land was ownership of the land. Lord Coke said: "If a man seized of land in fee by his deed granteth to another the profits of these lands, to have and to hold him and his heirs, and maketh livery *secundum formam*

[3] And cf. Bisbee-Baldwin v. Tomlinson, 5 Cir., 1963, . . . F.2d . . . (No. 19567).

chartae, the whole land itself doth pass. *For what is land but the profits thereof?*" Co. Lit. 45 [Emphasis added.]

There is, in law and fact, a vast difference between the present sale of the future right to *earn* income and the present sale of the future right to *earned* income.[4] If an asset will not in the future be useful, or capable of earning income, it is worthless in the business world.

We conclude, therefore, that the sale was not merely the present sale of the right to earned income, to be paid in the future. Taxpayer had an asset, a right, a property which would produce income. The fact that the income which *could* be earned would be ordinary income is immaterial; such would be true of the sale of all income-producing property. See *Commissioner v. Ferrer*, 1962, 2 Cir., 304 F.2d 125, especially the discussion beginning in the last paragraph in page 132.

We readily distinguish *Wiseman v. Halliburton Oil Well Cementing Co.*, 10 Cir., 1962, 301 F.2d 654, relied on by the government. Although the facts appear similar, it is plain that, in that case, the taxpayer had the right to sublicense the patent to third parties for a fee. He gave up that right in return for a share of royalties received by the patent owner from licenses to be granted to third parties. That is not the case here, inasmuch as taxpayer had no right to allow other parties to practice the patent. Perhaps in *Halliburton* the taxpayer merely substituted the right to receive ordinary income from one source for the right to receive ordinary income from another; but that is not

[4] But see *Roscoe v. Commissioner*, 5 Cir., 1954, 215 F.2d 178.

the case here inasmuch as taxpayer had no right to grant to third parties the right to practice the patent.

The second question is whether there was a sale or exchange of property rather than merely a "termination" or relinquishment." It is plain that before the transaction, taxpayer had a right in property; after the transaction was consummated, it no longer had this right, but a claim to money. If the transaction had been with a third party rather than the original patent holder, there would be no question but that a "transfer" was made. We see no difference. *Commissioner v. Ray*, 5 Cir., 1954, 210 F.2d 390; *Commissioner v. Ferrer*, *supra*. In *Ray*, a no-competition clause in a real estate lease was the subject of the "sale or exchange." We quote a portion of our opinion in that case (210 F.2d pp. 391-392), which we think applies equally here:

> "'A sale in the ordinary sense is a transfer of property for a fixed price in money or its equivalent. Examine the circumstances here, the precedent condition, the transaction and the subsequent condition. Before the transaction the taxpayer had a valuable property right, intangible but nonetheless property, a restrictive covenant in his lease [imposing a servitude on the property] which prevented competition in his trade or business. Before the transaction [which freed the property from this servitude] the lessor lacked a valuable right, the right to lease its premises to whomsoever it chose upon whatever terms it could arrange

[and to sell it free of the servitude]. True, it had once possessed this right, but it had conveyed the right for a consideration to the taxpayer. In the transaction the lessor gave its $20,000 to the taxpayer and in exchange the taxpayer gave to the lessor what it had not immediately theretofore possessed, the right to lease its premises to whomsoever it chose at whatever terms it could arrange.

"'The Commissioner's position apparently depends upon a view that the restrictive covenant when transferred or released to the covenantor simply disappears, vanishes and becomes nothing and, therefore, cannot be the subject of a sale. The concept, it seems, overlooks the substantial fact that it is the right freely to lease that is the subject of the transaction. Intangible though the property may be, it is real and valuable to both parties to the transaction [a servitude imposed by] a restrictive covenant in the hands of the taxpayer, [an unburdened], a freely exercisable right in the hands of the lessor. The Commissioner's view conceives the covenant as the thing and ignores the status of the intangible right [the servitude it imposes] involved as the substance of the sale. * * * In the commissioner's view property rights which disappear or, as he expresses it, vanish upon a relinquishment, surrender or transfer cannot be the subject of a sale even though the transfer or surrender or relinquishment for a consideration is that which, [by reuniting servient and dominant

estate] effects the vanishment. There is much authority to the contrary [of these views]."

"We agree with the respondents' reasoning and with that of the authorities upon which they rely. We particularly agree with what is said in the opinion of the Tax Court and in that of the Court of Appeals in the Golonsky case (*Commissioner v. Golonsky*, 200 F.2d 72). Because we do and because the opinions in those cases have, we think, not only correctly determined the issue presented here, but adequately set out the correct reasons for that determination, we will not attempt to restate those reasons. We will content ourselves with saying that, for the reasons advanced in those opinions, the decision and order of the Tax Court was right and it is affirmed."

Commissioner v. Star Bros., Inc., 2 Cir., 1953, 204 F.2d 673, which held that a release of an exclusive sales agency was not a sale or exchange, has been repudiated by the Second Circuit in *Commissioner v. Ferrer*, *supra*. We agree with the Second Circuit's disposition of the problem in *Ferrer* and adhere to the position taken by us in *Ray*.

The government's argument, running all through its brief, that capital gains treatment should not be allowed because the reason for the preferential treatment given capital gains[5] is not present, if at all

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5 "The preferential treatment of profits as capital gains is a statutory exception to the usual treatment of such profits as ordinary income, and, therefore, the statute must be strictly construed. The purpose of the excepting statute is to ameliorate tax burdens on gains accruing over a substantial period of time and

relevant, ignores the fact that the valuable right transferred by taxpayer back to Well-Surveys, Inc. did build up over a period of years. What increased in this case, over those years, was the value of the right "exclusively" to practice the patent. When that right was sold back to Well-Surveys, Inc., a capital gain occurred. It should be so taxed.

AFFIRMED.

BROWN, Circuit Judge, concurring:

I concur fully in the Court's action and opinion. I would add this by way of emphasis.

Running through several of our prior opinions is the asserted concept that capital gains versus ordinary income is to be determined by the status of current earnings were the asset to have remained in the hands of the transferor. On this approach it is reasoned that if the current income would have been taxable ordinary income, then the sales price which represents the substitute for such future earnings is likewise taxable ordinary income.

I think this is both bad economics and faulty law. A person acquires property for one of two, or both reasons. The first is to receive earnings, i.e., income. The other is to hold the property for appreciation resulting from long or short range economic conditions, inflation or the like. Normally, of course, the pre-

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realized in one particular year upon the conversion of a capital investment; it has no application where future ordinary income is anticipated, as in this case." Quoted from the Government's brief.

dominant reason is to acquire the earning capacity represented by the earnings which the property will generate.

Hence it is that among those who trade in corporate securities on established national exchanges or over-the-counter markets, there are recognized rules of thumb by which the present value, hence market price, is determined for a given stock. The same is true in the contemporary, frequent practice of large-scale corporate acquisitions by one corporation of the stock or assets of another corporation. Value — market or sales price — is determined by capitalizing earnings. Whether the formula is the conservative one of 6 or 7 times earnings, or something less, or one considerably more speculative, what the buyer offers is his estimate of the present, discounted value of the future earnings of the assets or enterprise.

But although this sales price is determined by future earnings, and to the seller it takes the place of what he would have received had he continued his ownership, under no stretch of the imagination is is "ordinary income" either in the business world or in the sometimes more weird, tax world. Were this so, then every such sale for a price in excess of cost would entail this analysis and this tax consequence. There would first have to be ascertained what portion of the excess represented the present value of future earnings and what portion represented merely capital appreciation, from enhancement in value caused by inflation, scarcity or the like. Then as a second step, that portion or the excess of sales price representing future earnings would be taxed as ordinary income, the remainder as capital gains.

Conceding that Congress might compel this, that the ubiquitous and voracious tax gatherer might demand it, or that courts might ultimately sustain it, the fact is that as yet none has gone so fast so far. And that is so because of the practical economic realities which are, after all, of dominant significance in tax affairs. Income is one thing. When income, and income alone is sold or transferred, it keeps this status. But when the thing which generates the income is transferred, what is paid and received is not vicarious income, whether viewed from an economic or a tax standpoint. It is, as the economist and the businessman views it, the present, discounted value of its future earnings. If the "thing" generating such future earnings is "property" of a kind which the tax law recognizes as one entitled to capital gains or losses when used in the tax law sense, that present, discounted value is a capital gain, not ordinary income notwithstanding the economic fact that without such capacity to earn "ordinary income" in the hands of its owner the asset would be valueless.

Tax law, by the hand of man, the Acts of Congress, and the doubtful clarification by Judges is complex enough without making it more so through the importation of bad economics. For before we realize it, economics which knows no law of stare decisis, is infected by poor or bad law to set in train tax consequences because of what Courts have said, not because of what the actualities really are.